



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	01/14/08	Bill No:	SB 1098
Tax:	Sales and Use	Author:	Migden
Related Bills:			

BILL SUMMARY

This bill would, among other things, provide amnesty for unpaid tax, interest and penalties on any sales of tangible personal property by a medical cannabis dispensary, as defined, prior to October 1, 2005 if the dispensary applies for relief by March 31, 2009 and begins prospective compliance with the Sales and Use Tax Law, as specified.

ANALYSIS

CURRENT LAW

Under existing law, except where specifically exempted by statute, sales tax is imposed on all retailers for the privilege of selling tangible personal property at retail in this state. Tangible personal property is defined in law to mean any personal property which may be seen, weighed, measured, felt, or touched, or which is in any other manner perceptible to the senses. Therefore, under the law, retail sales of marijuana and any other illegal drugs or property, are subject to tax to the same extent as any other lawful retail sale of tangible personal property.

Under the law, every person engaged in the business of selling tangible personal property of a kind the gross receipts from the retail sale of which are subject to tax is required to apply to the Board for a permit on a form prescribed by the Board. Wholesalers, as well as retailers, must obtain a permit. Under the law, a person that engages in business as a seller in this state without a seller's permit and each officer of any corporation which so engages in business, is guilty of a misdemeanor.

Also, under existing law, persons who fail to file a return and pay their tax obligations can be held liable for past tax obligations, together with interest and penalties, for up to eight prior years (except in the case of fraud which has no limitation period in which to assess past tax obligations).

Under existing law, the Board administers a voluntary disclosure program for certain out-of-state retailers. Under Revenue and Taxation Code Section 6487.05, unregistered out-of-state retailers may voluntarily register with the Board and may be able to limit their liability for tax, penalties and interest due. Under the voluntary disclosure program, if an out-of-state retailer qualifies, its liability for past tax obligations would be limited to the previous three years (rather than eight years) and relief of penalties may be provided.

Also, the Board will be sponsoring a measure this year to reinstate a similar voluntary disclosure program for certain purchasers of tangible personal property that have made purchases without payment of California use tax from out-of-state retailers (this two-year program was originally authorized by Assembly Bill 1741 (Stats. 2003, Ch. 697, effective January 1, 2004) and was extended for an additional two years by AB 671 (Stats. 2005, Ch. 308), and expired on January 1, 2008).

PROPOSED LAW

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This bill would, among other things, add Article 1.7 (commencing with Section 7067) to Chapter 8 of the Sales and Use Tax Law to specify that a medical cannabis dispensary engaged in business in this state of selling marijuana for medical purposes that has failed to file a return or pay amounts due under the Sales and Use Tax Law shall be relieved of liability of tax, interest, and penalty on its sales of tangible personal property made prior to October 1, 2005, if both of the following occur:

- 1) The dispensary applies for voluntary disclosure relief no later than March 31, 2009, in a form prescribed by the Board.
- 2) The dispensary begins prospective compliance with the Sales and Use Tax Law, as described.

The bill would also specify the following:

- If the dispensary fails to make a good faith effort to comply with the Sales and Use Tax Law, the Board may disallow the relief provided by the bill.
- The Board shall retain the right to audit dispensaries and assess any tax, penalty, and interest that may be determined to be due.
- Nothing in this article shall be construed to allow a refund to a dispensary for any amounts paid prior to the effective date of the bill.
- The relief provisions do not apply to any dispensary that has collected sales tax reimbursement prior to October 1, 2005.
- The Board shall separately identify in its records the dispensaries that apply for voluntary disclosure relief.

The bill would define “medical cannabis dispensary” or “dispensary” as any person or entity that engages in retail sales of marijuana for medical purposes to qualified patients or patients’ primary caregivers pursuant to specified provisions of the Health and Safety Code, commonly referred to as the Compassionate Use Act of 1996 and the Medical Marijuana Program.

The provisions of the bill would become effective on January 1, 2009.

BACKGROUND

Existing state law, as authorized under the Compassionate Use Act of 1996 (Proposition 215 of 1996), allows patients or primary caregivers to cultivate or possess marijuana for medical use when recommended by a physician, as specified.

Despite the fact that numerous medical cannabis dispensaries are currently in business in California, the sale of medical cannabis is strictly illegal under federal law. Under state law, the sale is lawful in certain defined circumstances as provided by SB 420 (Ch. 875, Stats. 2003), which established statewide guidelines for Proposition 215 enforcement. In particular, non-profit distribution is allowed in certain cases for patient cultivation co-ops and small-scale caregiver gardeners.

Up until late 2005, the Board’s longstanding policy was to not issue a seller’s permit to a person whose sole selling activity is the unlawful sale of tangible personal property, so as not to confer permissive authority or condone an illegal activity. However, although it was Board policy to not issue seller’s permits, the sales tax applies to all retail sales of illegal substances or property in this state and the Board may audit and make assessments of any unreported tax on such sales.

However, after hearing a case that came before the Members of the Board involving medical marijuana sales, and recognizing the difficulty in reconciling the Board's authority to issue assessments for taxes due from a seller's marijuana sales while not issuing seller's permits to such sellers, as well as taking into account the legality under state law of some sales of marijuana as authorized in SB 420, the Board changed its policy. Now, the Board issues seller's permits to those medical marijuana sellers that apply and will issue seller's permits to any other sellers making unlawful sales. And, in order to reduce concerns about confidentiality and self-incrimination, the Board allows an applicant of a seller's permit to omit information normally requested on the application, such as the products the applicant intends to sell, the names and addresses of suppliers, and the products the applicant intends to purchase.

In previous years, California has administered amnesty programs that applied to all sellers of tangible personal property. These programs occurred in 1984 (AB 3230, Ch. 1490) and in 2004 (SB 1100, Ch. 226). Unlike this bill, however, these amnesty measures only provided relief of penalties and a waiver of any criminal action that could be brought against the taxpayer. Past tax obligations, as well as applicable interest, were not relievable under either of the programs. Also, unlike this measure, both programs provided post-amnesty enforcement provisions, such as enhanced penalties for a person's failure to come forward during the amnesty period.

Last year, a similar measure, SB 529 (Migden), was introduced to also provide amnesty to medical cannabis dispensaries. That measure was different from this bill, as it would have provided relief for all past obligations on sales made prior to the effective date of the measure. That measure was subsequently amended to delete the amnesty provisions and later died in the Assembly.

COMMENTS

1. **Sponsor and purpose.** Senator Migden is sponsoring this measure in an effort to encourage medical marijuana dispensaries to come forward and begin complying with the tax laws.
2. **Would dispensaries come forward and expose themselves at the risk of self-incrimination?** In June 2005, the U.S. Supreme Court (6-3 vote) in *Gonzales v. Raich* held that federal laws prohibiting the use of medical marijuana remain in effect regardless of state laws that permit its use. Regardless of amnesty, there will be those who won't come forward for fear of self-incrimination resulting in punitive measures from the federal government. If a dispensary fails to come forward by March 31, 2009, as specified in the bill, that dispensary could be held liable for past tax liabilities for up to eight years, together with interest and penalties.
3. **The provision that requires the Board to separately identify persons who come forward may further discourage some.** The bill requires the Board to separately identify in its records dispensaries that come forward and request relief under the provisions of the bill. The risks associated with federal prosecution may far outweigh the benefit this tax amnesty measure has to offer, and dispensaries concerned with those risks may never come forward – especially with the understanding that the Board would be separately identifying these entities.

Although a separate identification of these entities would enable the Board to capture specific data on the level of enhanced compliance as a direct result of this measure, a separate identification of the dispensaries would also enable the Board,

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if requested, to readily share specific information about each dispensary with local law enforcement or the United States Attorney (the Board has long-standing information-sharing agreements with various federal, state, and local government agencies, and pursuant to a Governor's Order, the Board is authorized to share information with local law enforcement and the United States Attorney).

4. **What are the dispensaries' obligations between October 1, 2005 and the effective date of the bill?** The bill would relieve dispensaries of their tax obligations on sales made *prior* to October 1, 2005 provided the dispensary begins prospective compliance and obtains a seller's permit, files returns and remits amounts due *subsequent* to the bill's effective date. However, this leaves some question about the necessity of filing returns and remitting past amounts due on taxable sales made between the period October 1, 2005 and the bill's effective date (January 1, 2009). Would a dispensary be regarded as beginning "prospective compliance" if the dispensary fails to promptly file all past due returns and pay all past due tax obligations, but begins prospective compliance as the language requires? This should be clarified.
5. **While the bill would not be problematic to administer (provided the issue in the comment above is addressed), the bill extends amnesty to all sales of tangible personal property by dispensaries.** Previously, the Board did not issue seller's permits to persons who engaged solely in the sale of marijuana. However, if an applicant disclosed the fact that other sales of tangible personal property would be made in addition to marijuana, the Board's policy was to issue the permit for the lawful sales, and to inform the applicant that, although sales tax applies to the sales of marijuana, the permit does not *allow for the sale* of "medical" marijuana or other illegal merchandise. Since there was no change in policy to lawful sales of tangible personal property, and since many of these dispensaries make other taxable sales such as t-shirts, hats, and pipes, should liabilities attributable to these taxable sales be included within the amnesty provisions?
6. **Recommended technical amendments:**
 - On page 3, line 22, "on sales made" should be added after "sales tax reimbursement"
 - On page 3, line 24, "marijuana" should be replaced with "medical"

COST ESTIMATE

Some administrative costs would be incurred in identifying and notifying medical cannabis dispensaries, processing applications for relief, monitoring dispensaries' prospective compliance with the law, and responding to inquiries. An estimate of these costs is pending.

REVENUE ESTIMATE

BACKGROUND, METHODOLOGY, AND ASSUMPTIONS

According to a report published by the California branch of the National Organization for the Reform of Marijuana Laws (Cal Norml), a non-profit membership organization dedicated to reforming marijuana laws, there are over 400 medical cannabis dispensaries in California. We reviewed approximately a third of the listed dispensaries, to determine whether they were registered with the Board. We found that 34 of these dispensaries have active seller's permit accounts, 21 (representing 5% of all medical cannabis dispensaries – 21/400) reported gross annual sales of \$47.6 million, the remaining 13 active accounts have no reported gross sales. We will assume that the \$47.6 million in sales are derived from medicinal marijuana or other taxable items. Since we only researched a third of Cal Norml's list, we estimate that the actual number of registered dispensaries reporting taxable sales could be as much as 15% (3 x 5%) of all California dispensaries listed in the Cal Norml's report. The gross annual sales of these dispensaries that may be currently registered with the Board is estimated to be \$142.8 million (15% divided by 5% x \$47.6 million).

According to an internet article published by *The Scotsman Publications Ltd* (2007), since the state-wide referendum decriminalizing marijuana in 1996 (the Compassionate Use Act of 1996) medicinal marijuana has grown into a billion-dollar industry. In a report, [Revenue and Taxes from Oakland's Cannabis Economy](#) published in November 2006 by the City of Oakland's Measure Z Oversight Committee, it was quoted that "the total California medical cannabis market can be estimated at \$870 million - \$2 billion". For this estimate, we will use a conservative amount of \$1 billion to be the California market for medicinal marijuana sales.

The cultivation, sale, and use of marijuana are felony violations of federal law. The Drug Enforcement Administration (DEA) and the U.S. Department of Health and Human Services pursuant to the Comprehensive Drug Abuse Prevention and Control Act of 1970, has defined marijuana as a Schedule 1 drug. Among other findings, Schedule 1 drugs are said to have no currently accepted medical use in treatment in the United States. No prescriptions may be written for Schedule 1 substances. In June 2005, the U.S. Supreme Court (6-3 vote) in *Gonzales v. Raich* held that federal laws prohibiting the use of medical marijuana remain in effect regardless of state laws that permit its use. No matter what the extent the tax amnesty provisions apply, there will be those that want to be treated like legitimate businesses that will come forward and comply with the tax laws, and there will be those who would not come forward for fear of self-incrimination resulting in punitive measures from the federal government. Also, due to the fact that the amnesty provisions in this bill do not provide amnesty for the period October 1, 2005 and the bill's effective date, some dispensaries would be further discouraged from coming forward. In our estimate, we will assume that only one quarter of the total sales by medicinal marijuana dispensaries not currently reported to the Board would be realized. We estimate that the prospective annual state and local revenue increase would amount to \$17 million ((1 billion -142.8 million) / 4 x 7.95%).

	Gross Receipts
Estimate Annual Medicinal Marijuana	\$1,000,000,000
Estimated Sales Currently Reported	- 142,800,000
Sales Unreported to the Board	<u>\$ 857,200,000</u>
<u>Tax Amnesty Voluntary Reporting (1/4)</u>	<u>\$ 214,300,000</u>

This bill provides amnesty for medicinal marijuana entities that have not filed returns or paid taxes due under the Sales and Use Tax Law. The bill does not provide tax amnesty on sales tax obligations from the date of voluntary disclosure (March 31, 2009) back to October 1, 2005, or 3 ½ years for businesses that have filed returns but have not remitted sales and use tax on amounts due under the law. The Board also has authority to go back eight years for those businesses that have not filed returns and remitted sales and use tax on amounts due under the law. In addition to the prospective annual state and local revenue increase, we estimate that the amount of retroactive state and local revenue dating back to October 1, 2005 that would be reported pursuant to this tax amnesty proposal is approximately \$59.5 million (\$17.0 million x 3 ½ years).

REVENUE SUMMARY

The proposed tax amnesty program would result in an annual ongoing prospective state and local revenue increase of \$17.0 million, and \$59.5 million (3 ½ years x \$17 million) in one time retroactive revenues as follows:

Tax Amnesty

Annual revenue	Revenue Gain
State (5.00%)	\$ 10,700,000
Fiscal Recover Fund (0.25%)	500,000
Local (2.00%)	4,300,000
District Tax (0.70%)	1,500,000
Total annual ongoing revenue	<u>\$ 17,000,000</u>
Retroactive one time revenue	Revenue Gain
State (5.00%)	\$ 37,450,000
Fiscal Recover Fund (0.25%)	1,750,000
Local (2.00%)	15,050,000
District Tax (0.70%)	5,250,000
Total one time revenue	<u>\$ 59,500,000</u>

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